

REPORT OF EXAMINATION  
OF THE  
WESTERN UNDERWRITERS  
INSURANCE COMPANY  
AS OF  
DECEMBER 31, 2004

Filed December 8, 2005

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Los Angeles, California  
October 7, 2005

Honorable John Garamendi  
Insurance Commissioner  
California Department of Insurance  
Sacramento, California

Dear Commissioner:

Pursuant to your instructions, an examination was made of the

**WESTERN UNDERWRITERS INSURANCE COMPANY**

(hereinafter also referred to as the Company) at its home office located at 5757 Wilshire Blvd., Suite 670, Los Angeles, California 90036.

**SCOPE OF EXAMINATION**

The previous examination of the Company was made as of December 31, 2001. This examination covers the period from January 1, 2002 through December 31, 2004. The examination included a review of the Company's practices and procedures, an examination of management records, tests and analyses of detailed transactions within the examination period, and an evaluation of the assets and a determination of liabilities as of December 31, 2004, as deemed necessary under the circumstances.

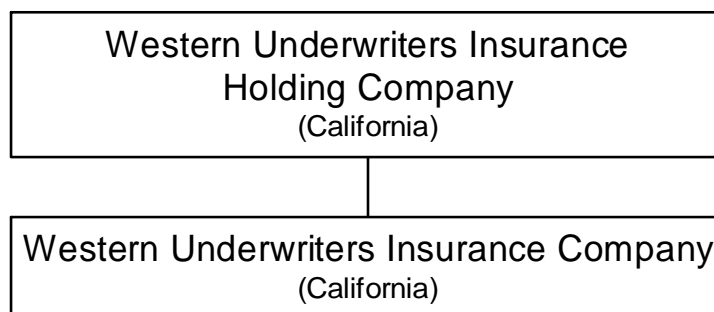
In addition to those items specifically commented upon in this report, other phases of the Company's operations were reviewed including the following areas that require no further comment: fidelity bonds and other insurance; officers', employees' and agents' welfare and pension plans; growth of company; business in-force by states; loss experience and sales and advertising.

## COMPANY HISTORY

The Company was incorporated in the State of California on August 29, 1996. On February 4, 1998, the Company sold 26,000 shares of its \$100 par value common stock to its parent, Western Underwriters Insurance Holding Company, at \$207.70 per share, for a total consideration of \$5,400,200. In October 1998, the Company's parent made a capital contribution of \$446,142 to the Company. In 2003 and 2004, the Company's parent, Western Underwriters Insurance Holding Company made additional capital contributions of \$4,521,000 and \$588,920, respectively. The source of the contribution was from the original investors.

## MANAGEMENT AND CONTROL

The Company is a member of an insurance holding company system and is a wholly-owned subsidiary of Western Underwriters Insurance Holding Company. As of December 31, 2004, the primary investors of Western Underwriters Insurance Holding Company are Western/Re Managers Insurance Services, Inc. (22.5%), Western Holdings (Bermuda) Ltd. (20.2%), Mr. Donald W. Grant (17.7%) and North Shore Management (9.4%). The remaining (30.2%) interest is held by eighteen other investors. The following organizational chart depicts the Company's relationship within the holding company system:



Management of the Company is vested in a five-member board of directors elected annually. A listing of the members of the board and principal officers serving on December 31, 2004 follows:

Directors

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>
Donald W. Grant Los Angeles, California	President Western Underwriters Insurance Holding Company
Lon A. Varnadore Palos Verdes Estates, California	Secretary Western Underwriters Insurance Holding Company
Ed Dziadkowicz Long Beach, California	Treasurer Western Underwriters Insurance Holding Company.
Donald Greene West Hampton, New York	Retired Insurance Attorney
David Emmerich Northbrook, Illinois	President North Shore Management Associates

Principal Officers

<u>Name</u>	<u>Title</u>
Donald W. Grant	President
Lon A. Varnadore	Secretary
Ed Dziadkowicz	Treasurer

## Management Agreements

Administrative Services and Management Agreement: On March 20, 2000, the Company entered into an Administrative Services and Management Agreement with Western/Re Managers Insurance Services, Inc. (WR). Under the terms of the agreement, WR provides the Company with administrative services such as accounting and human resources, including rent, at no cost to the Company. The prior examination report recommended that the agreement be submitted to the California Department of Insurance (CDI) for approval in accordance with California Insurance Code (CIC) Section 1215.5 (b) (4). The Company did not comply. It is recommended that the Company comply with CIC Section 1212.5 (b) (4) and submit this agreement to the CDI for approval.

Underwriting Managers Agreement: On April 20, 1998, the Company entered into an underwriting agreement with its affiliate, WR. Under the terms of the agreement, WR solicits and underwrites applications for insurance and reinsurance, issues binders, insurance policies and reinsurance certificates, bills for and collects premiums and in general, manages the Company's business under the Company's supervision. All premiums are remitted by WR to the Company within ninety days from the actual booking month of each transaction. This agreement was not submitted to the CDI for approval as required by California Insurance Code (CIC) Section 1215.5(b) (4). It is recommended that the Company comply with CIC Section 1215.5 (b) (4) and submit this agreement to the CDI for approval.

Federal Income Tax Agreement: On May 31, 2002, the Company entered into a Federal Income Tax Agreement with its parent, Western Underwriters Insurance Holding Company (WU). Under the terms of the agreement, WU files a consolidated federal income tax return in which the federal income tax liability is allocated among the two companies in the ratio that each company's separate tax return liability bears to the total consolidated federal tax liability.

## CORPORATE RECORDS

The Company is not in compliance with California Insurance Code (CIC) Section 735 which states that the Company must inform the board members of the receipt of the examination report. The board should be informed of the report both in the form first formally prepared by the examiners and in the form as finally settled and officially filed by the commissioner. The board must also enter these facts in the board minutes. A review of the board minutes disclosed that, neither the officially filed report nor the first formally prepared draft by the examiners was presented to the board members.

The Company is not in compliance with CIC Section 1200 and 1201 which require the board to authorize and approve investments. The Company's minutes failed to document the authorization or approval of its investments. In addition, specific references to amounts, facts and the values of the securities were not included as required under CIC Section 1201.

It is recommended that the Company comply with CIC Sections 735, 1200 and 1201.

## TERRITORY AND PLAN OF OPERATION

The Company is licensed in California only and has no immediate plans to apply for admission into any other states. The Company acts exclusively as a reinsurer and does not directly underwrite any insurance risks. The Company reinsures difference in conditions (DC) property and earthquake (stand alone) insurance on an excess basis only, through a reinsurance agreement with Greenwich Insurance Company. DC insurance is designed to insure perils that are not normally covered by a commercial fire insurance or an all risk policy. In 2005, the Company obtained approval from the California Department of Insurance to write DC policies in California on a direct basis. The total direct premium written through nine months of 2005 is \$60,557. The source of direct business is through wholesale insurance brokers.

## REINSURANCE

### Assumed

Effective July 1, 1998, the Company entered into a quota-share reinsurance agreement with Greenwich Insurance Company (GIC) to reinsure policies issued by GIC on business produced by Western Re/Managers Insurance Services, Inc. Under the terms of the amended agreement, effective January 1, 2001, GIC's limit of liability is not to exceed \$1.5 million with the Company reinsuring 75% of this limit.

Although the reinsurance agreement has no specific language regarding the determination and calculation of contingent commissions, it was noted that the Company accrued \$324,103 in its year-end 2004 financial statements for contingent commissions relating to this agreement. It is recommended that the agreement be amended to include specific language as to how the contingent commissions are determined and calculated.

### Ceded

On April 1, 2001, the Company and GIC renewed their catastrophe excess of loss coverage for a combined limit of \$3 million excess of \$750,000, led by Alea London Limited (60%), Underwriters at Lloyds (23.158%), G. E. Frankona Reinsurance Limited (8.421%), and CNA Re (8.421%).

On the renewal of the catastrophe reinsurance on April 1, 2002, the limit was increased to \$8 million excess of \$2 million, led by Alea London Limited (60%) and the balance with Underwriters at Lloyds (40%).

In April of 2003, the limit was reduced to \$5 million excess of \$5 million, led by Alea London Limited (100%), following a review that indicated the earthquake exposures were reduced.



A review of this reinsurance agreement disclosed that the insolvency clause does not comply with California Insurance Code (CIC) Section 922.2(a)(2). It is recommended that the Company amend its current reinsurance agreement with GIC and Alea London Limited to include an insolvency clause that complies with CIC Section 922.2(a)(2).

### ACCOUNTS AND RECORDS

A review of the 2004 Annual Statement, Schedule Y, Part 2 disclosed that the Company did not report transactions with affiliates as required by the Annual Statement instructions. It is recommended that the Company comply with the Annual Statement instructions and disclose all required transactions with affiliates.

### FINANCIAL STATEMENTS

The financial statements prepared for this examination report include:

Statement of Financial Condition as of December 31, 2004

Underwriting and Investment Exhibit for the Year Ended December 31, 2004

Reconciliation of Surplus as Regards Policyholders  
from December 31, 2001 through December 31, 2004

Statement of Financial Condition  
as of December 31, 2004

<u>Assets</u>	<u>Ledger and Nonledger Assets</u>	<u>Net Admitted Assets</u>	<u>Notes</u>
Bonds	\$ 10,843,474	\$ 10,843,474	(1)
Stocks:			
Preferred stocks	806,551	806,551	(1)
Cash and short-term investments	3,191,697	3,191,697	
Agents' balances or uncollected premiums:			
Premiums and agents' balances in course of collection	376,768	376,768	
Other invested assets	1,013,605	1,013,605	
Investment income due and accrued	<u>121,374</u>	<u>121,374</u>	
Total assets	<u>\$ 16,353,469</u>	<u>\$ 16,353,469</u>	
<u>Liabilities, Surplus and Other Funds</u>			
Losses and loss adjustment expenses		\$ 1,191,211	(2)
Commissions payable, contingent commissions		662,222	
Unearned premiums		532,804	
Current federal and foreign income taxes		191,999	
Payable to parent, subsidiaries and affiliates		<u>107,718</u>	
Total liabilities		2,685,954	
Common capital stock	\$ 2,600,000		
Gross paid-in and contributed surplus	8,385,120		
Unassigned funds (surplus)	<u>2,682,395</u>		
Surplus as regards policyholders		<u>13,667,515</u>	
Total liabilities, surplus and other funds		<u>\$ 16,353,469</u>	

Underwriting and Investment Exhibit  
for the Year Ended December 31, 2004

Statement of Income

Underwriting Income

Premiums earned		\$ 1,561,907
Deductions:		
Losses incurred	\$ 25,610	
Other underwriting expenses incurred	<u>790,368</u>	
Total underwriting deductions		<u>815,978</u>
Net underwriting gain		745,929

Investment Income

Net investment income earned	\$431,933	
Net realized capital losses	<u>(428)</u>	
Net investment gain		431,505

Other Income

Aggregate write-ins for miscellaneous income	<u>150</u>	
Total other income		<u>150</u>
Net income before federal income taxes		1,177,584
Federal income taxes incurred		<u>(390,730)</u>
Net income		<u>\$ 786,854</u>

Capital and Surplus Account

Surplus as regards policyholders, December 31, 2003		\$ 12,291,740
Net income	\$ 786,854	
Surplus adjustments - Paid in	<u>588,920</u>	
Change in surplus as regards policyholders		<u>1,375,774</u>
Surplus as regards policyholders, December 31, 2004		<u>\$ 13,667,514</u>

Reconciliation of Surplus as Regards Policyholders  
from December 31, 2001 through December 31, 2004

Surplus as regards policyholders, December 31, 2001, per Examination		\$ 6,698,498
	<u>Gain in Surplus</u>	
Net income	\$ 1,859,097	
Capital changes: Paid-in	<u>5,109,920</u>	
Totals	<u>\$ 6,969,017</u>	
Net increase in surplus as regards policyholders		<u>6,969,017</u>
Surplus as regards policyholders, December 31, 2004, per Examination		<u>\$ 13,667,515</u>

## COMMENTS ON FINANCIAL STATEMENT ITEMS

### (1) Bonds and Stocks

The Company maintains a majority of its bonds and all of its preferred stocks with Wedbush Morgan Securities Inc. (Wedbush), who is not a qualified custodian or subcustodian as defined under California Insurance Code (CIC) Section 1104.9. It is recommended that the Company maintain all of its assets in the State of California with a qualified custodian or subcustodian. In addition, it is recommended that the Company enter into a custodial agreement with a qualified custodian and submit the custodial agreement to the California Department of Insurance (CDI) for approval in compliance with CIC Section 1104.9.

### (2) Losses and Loss Adjustment Expenses

Based on a review of the Company's loss and loss adjustment expense reserves by a Casualty Actuary from the CDI, the Company's reserves for losses and loss adjustment expenses were determined to be reasonably stated and have been accepted for purposes of this examination.

## SUMMARY OF COMMENTS AND RECOMMENDATIONS

### Current Report of Examination

Management and Control (Page 4): It is recommended that the Administrative Services and Management Agreement be submitted to the California Department of Insurance (CDI) for approval in accordance with the California Insurance Code (CIC) Section 1215 (b) (4). This recommendation was also made in the prior examination report.

Management and Control (Page 4): It is recommended that the Company comply with CIC Section 1215.5 (b) (4) and submit its Underwriting Managers Agreement to the CDI for approval.

Corporate Records (Page 5): It is recommended that the Company comply with CIC Sections 735, 1200 and 1201.

Reinsurance-Assumed (Page 6): It is recommended that the reinsurance agreement with Greenwich Insurance Company be amended to include specific language as to how the contingent commissions are determined and calculated.

Reinsurance-Ceded (Page 7): It is recommended that the Company amend its current reinsurance agreement with Greenwich Insurance Company and Alea London Limited to include an insolvency clause that complies with CIC Section 922.2(a)(2).

Accounts and Records (Page 7): It is recommended that the Company comply with the Annual Statement instructions and disclose all required transactions with affiliates.

Bonds and Stocks (Page 11): It is recommended that the Company maintain all of its assets in the State of California with a qualified custodian or subcustodian. In addition, it is recommended that the Company enter into a custodial agreement with a qualified custodian and submit the custodial agreement to CDI for approval in compliance with CIC Section 1104.9.

#### Previous Report of Examination

Management and Control- Management Agreements (Page 4): It was recommended that the Administrative Services and Management Agreement be submitted to the CDI for approval. The Company did not comply with the recommendation.

### ACKNOWLEDGEMENT

The courtesy and cooperation extended by the Company's officers and employees during the course of this examination are hereby acknowledged.

Respectfully submitted,

\_\_\_\_\_/S/  
Victoria Wang  
Examiner-In-Charge  
Associate Insurance Examiner  
Department of Insurance  
State of California